

General Information Letter: A petition for permission to use an alternative apportionment method cannot be granted based on an assertion of distortion that is not supported by any evidence.

March 18, 2008

Dear:

This is in response to your letter dated March 7, 2008, in which you request permission to use a three-factor (payroll, property and sales) apportionment formula rather than the statutorily-mandated single sales factor apportionment formula, pursuant to Section 304(f) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 101 *et seq.*). The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us. For the reasons discussed below, your petition cannot be granted at this time.

In your letter you have stated the following:

The purpose of this letter is a request by COMPANY, Inc. & Subsidiaries (COMPANY) of alternative apportionment pursuant to IL Section 304(f) for the Illinois Corporate Income/Replacement Tax. Currently under Illinois statute, COMPANY is required to apportion their income to Illinois utilizing a single factor apportionment factor that is based solely on sales. It is the belief of COMPANY that this approach severely distorts their apportionment percentage.

Facts:

COMPANY is a fully integrated manufacturer of stainless steel. Its corporate headquarters is located in CITY, STATE1 with warehouses located in Illinois, STATE2, STATE3, & STATE4. All of the manufacturing activities occur in the state of STATE1. The warehouses store inventory and alter material through the use of Slitter Machines and Blanking Lines.

COMPANY's Illinois state apportionment percentages for the last three years are as follows beginning with 2006: 23.0664%, 21.7508%, and 20.3496%. Applying a three factor apportionment with sales being double weighted would result in the following percentages: 12.591% for 2006; 11.953% for 2005; and 10.936% for 2004. The single sales approach therefore distorts the percentages as follows: 183% for 2006; 182% for 2005; and 186% for 2004. COMPANY believes these distortions demonstrate the inequitable distribution caused by the single factor sales methodology.

COMPANY had \$2.5B in total sales during 2006. Of the \$2.5B in sales, \$256M of the sales was out of the warehouse located in Illinois, which equates to roughly 10% of total sales. This percentage is more in line with the apportionment % computed utilizing a three factor apportionment methodology with double weighted sales versus the single factor methodology that is currently prescribed under Illinois statute. At the end of 2006, COMPANY had invested \$66M of property in the state of Illinois along with \$1.5M of payroll. Tax Year 2005 produces similar results.

Conclusion:

The three factor apportionment methodology originated and was adopted by the majority of states that impose an income tax because there was the realization that a single factor apportionment methodology distorted results. The application of the single factor sales apportionment percentage clearly distorts the results for COMPANY. Couple that with the amount of investment COMPANY has contributed to the state of Illinois and the inequitableness is clearly highlighted. The alternative apportionment methodology being requested is also in line with the provisions set in place by UDITPA with the exception of the double weighting of the sales factor. COMPANY feels the double weighting brings the overall apportionment in line with its true economic position in Illinois. Although Illinois hasn't fully adopted the provisions of UDITPA, their statutes reflect the majority of the principles. The alternative methodology also produces a result that is line with the total amount of sales being generated from the Illinois warehouse in comparison to total sales of the company.

We hope that the Department of Revenue will look favorably upon our request and grant us relief by approving a three factor apportionment methodology with sales being double weighted.

Response

Section 304(f) of the IITA provides:

If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable:

- (1) Separate accounting;
- (2) The exclusion of any one or more factors;
- (3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

Taxpayers who wish to use an alternative method of apportionment under this provision are required to file a petition complying with the requirements of 86 Ill. Adm. Code Section 100.3390, which may be found on the Department's web site at [www. tax.illinois.gov](http://www.tax.illinois.gov).

86 Ill. Adm. Code Section 100.3390(c) provides:

A departure from the required apportionment method is allowed only where such methods do not accurately and fairly reflect business activity in Illinois. An alternative

apportionment method may not be invoked, either by the Director or by a taxpayer, merely because it reaches a different apportionment percentage than the required statutory formula. However, if the application of the statutory formula will lead to a grossly distorted result in a particular case, a fair and accurate alternative method is appropriate. The party (the Director or the taxpayer) seeking to utilize an alternative apportionment method has the burden of going forward with the evidence and proving by clear and cogent evidence that the statutory formula results in the taxation of extraterritorial values and operates unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in this State. In addition, the party seeking to use an alternative apportionment formula must go forward with the evidence and prove that the proposed alternative apportionment method fairly and accurately apportions income to Illinois based upon business activity in this State.

Your letter does not provide any evidence that application of the statutory formula results in the taxation of extraterritorial values or produces an unreasonable result, or to show that the use of the three-factor formula you request will fairly and accurately apportion the income of COMPANY, Inc., to Illinois, except to state that the statutory formula and the three-factor formula reach different results. Accordingly, 86 Ill. Adm. Code Section 100.3390(c) prohibits the grant of your petition.

Please note that 86 Ill. Adm. Code Section 100.3390(e)(1) requires a petition to be filed at least 120 days prior to the due date (including extensions) for the first return for which permission is sought to use the alternative apportionment method. A petition filed March 7, 2008 will allow a taxpayer to use the requested method on original returns due on or after Monday, July 7, 2008, if granted.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you still believe that your petition should be granted, please supplement the petition in accordance with the provisions of 86 Ill. Adm. Code Section 100.3390. If you have any questions, you may contact me at (217) 524-3951.

Sincerely,

Paul S. Caselton
Deputy General Counsel -- Income Tax